

May 15, 2000

Office of the Secretary  
Case Control Unit  
ATTN: STB Ex Parte No. 582  
Surface Transportation Board  
1925 K Street, N.W.  
Washington, DC 20423-0001

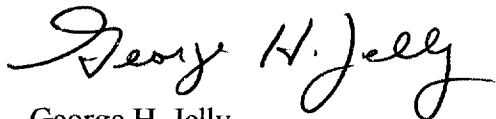
RECEIVED  
MAY 16 2000  
V.I.L. MANAGEMENT  
STB

Re: STB Ex Parte No. 582 (Sub-No. 1)  
Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed for filing in the above-referenced docket are an original and twenty-five copies of the Joint Statement of Shell Oil Company and Shell Chemical Company. Also enclosed is a 3.5 inch diskette, containing the Statement in a format which may be converted to Word Perfect 7.0.

Respectfully submitted,

  
George H. Jelly

BEFORE THE  
SURFACE TRANSPORTATION BOARD  
WASHINGTON, D. C.

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STB EX PARTE NO. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

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JOINT STATEMENT OF

SHELL OIL COMPANY

AND

SHELL CHEMICAL COMPANY

**Due Date: May 16, 2000**

**George H. Jelly  
Senior Transportation Representative  
Land Transportation Department  
Shell Chemical Company  
One Shell Plaza  
Post Office Box 2463  
Houston, Texas 77252**

BEFORE THE  
SURFACE TRANSPORTATION BOARD  
WASHINGTON, D. C.

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STB EX PARTE NO. 582 (Sub No. 1)  
MAJOR RAIL CONSOLIDATION PROCEDURES

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JOINT STATEMENT OF

SHELL OIL COMPANY

AND

SHELL CHEMICAL COMPANY

Shell Oil Company and/or Shell Chemical Company “for itself and as agent for Shell Oil Company” (hereinafter jointly referred to as “Shell”) hereby file a joint statement in response to request for same by the Surface Transportation Board (Board or STB) by its Decision served March 31, 2000 in Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures. Both companies are corporations, the address of which is One Shell Plaza, Post Office Box 2463, Houston, Texas 77252.

## STATEMENT OF GEORGE H. JELLY

Chairman Morgan, Vice Chairman Burkes, Commissioner Clyburn, my name is George H. Jelly. I am employed as Senior Transportation Representative in the Land Transportation Department by Shell Chemical Company and as agent for Shell Oil Company. My business address is 910 Louisiana Street, Houston, Texas 77002. My responsibilities include the purchasing of rail and truck transportation services and various aspects of rail fleet management for Shell Chemical, Shell Oil and affiliated companies.

The Board instituted this proceeding by seeking public comment regarding modifications to the procedures used in reviewing proposals for major rail consolidations. I will set forth Shell's comments after providing some background in terms of Shell interest and experience regarding these issues.

### SHELL INTEREST

Shell is a major shipper of petroleum, base chemical, feedstock and chemical products. Shell, its subsidiaries and joint venture partners own and/or operate 16 refineries and chemical plants in North America, employing about 20,000 people and spending in excess of \$160 million for transportation of raw materials, feed stocks and finished products. This equates to approximately 65,000 carload shipments annually.

### SHELL EXPERIENCE

Shell has seen service deteriorate and rates increase as a result of the consolidation in the railroad industry allowed by the Interstate Commerce Commission and the Surface Transportation Board over the past six years. Following the ICC approval of the Burlington Northern – Santa Fe merger, which reduced competitive options for a significant number of Shell movements, and the botched implementation of

its merger with the Chicago and North Western by the Union Pacific, Shell began to actively participate in proceedings before the ICC and STB.

Shell opposed the consolidation of the Union Pacific and Southern Pacific because of the anticompetitive effects we, and others in the industry, foresaw. Despite significant opposition from shippers, associations and government agencies, as well as the inability of the UP to integrate the operations of its biggest interchange partner, the C&NW, the Board approved its union with the much larger SP. The “direct, quantifiable cost savings for itself and its shippers of more than \$620 million dollars a year” which the Board predicted as a result of its approval of the UP-SP merger morphed instead into billions of dollars of losses for railroads and shippers alike in the UP service meltdown.

Shell also opposed the CSX-Norfolk Southern application to purchase and divide Conrail between themselves. In a statement filed by Shell’s former Manager of Land Transportation, Brian Felker, we stated:

“Shell’s opposition to the Conrail breakup as considered in this proceeding is based on three dangers to Shell in particular and shippers in general. Those dangers are service deterioration, acceleration of rate increases, and a continued decrease in railroad competition. While there are certainly some potentially positive aspects to the proposed transaction, they are far outweighed by the contribution it will make to a long term reduction in competition in the railroad industry, as well as the more immediate detrimental economic and service consequences.”

The accuracy of our prediction of service deterioration is self-evident. Among the key claims CSX and NS used to push their joint application forward was the promise to take trucks off of I-95 by providing seamless intermodal service. For Shell, and many other shippers we have talked with, the effect of the Conrail split has been just the opposite. We have been forced to ship traffic by truck that was previously carried by Conrail because of the inability of CSX and NS to move it.

The evidence is also in regarding the acceleration of rate increases. While the CSXT stated in its application that “our customers will benefit from our ability to spread fixed costs across a broader traffic base,” we find them singing a different tune now that the Conrail deal is done. According to a recent Journal of Commerce article, Chairman John Snow divulged CSXT strategy for increasing prices to a group of securities analysts. Chairman Snow said that CSXT will take advantage of “capacity constraints” in order to put through rate increases that stick. CSX will rely more on tariffs and less on contracts to accomplish this, according to Mr. Snow. This strategy was put into action with CSX notification, received recently by Shell and other shippers, that tariff rates would be increased by 5% across the board.

CSX senior vice president of merchandise marketing, John Sammon, added that when contracts are renewed they will also be subject to increases of 4%-4.5% per year as compared with recent escalations of 2%-2.5% per year. Mr. Snow concluded by saying that shippers will have to decide what it is worth to them to be able to move their freight.

As you might imagine, Shell’s willingness to believe the benefit claims that accompany the applications for consolidation diminishes with each new case. Shell opposition to the mergers cited above was based on a business imperative without which our U.S. plants cannot compete in global chemical markets - avoidance of unrestrained cost increases.

Shell production plants operate at varying margins of profitability. However, profitability goals based on corporate requirements for attracting capital and generating shareholder value must be met. A plant which is consistently unable to meet profitability

goals despite efforts to reduce costs and increase revenues will find production shifted to an alternative site; perhaps offshore.

Unrestrained increases in a key cost component such as rail transportation will contribute to a loss of U. S. production capacity, costing domestic manufacturing jobs as well as a decrease in the railroads' customer base. We are already dangerously close to this scenario at a number of facilities.

Shell is gravely concerned that the decrease in competition for rail transportation business engendered by the mergers of the 1990's, has created a situation where market forces are not sufficient to constrain rates at reasonable levels. Shell's experience with attempting to utilize the current rate reasonableness procedures has proven to be problematic, slow and costly. This is why we proposed, as a condition of UP-SP merger approval, that the STB provide swifter shipper access to regulatory protection from excessive rates by a finding of de facto railroad market dominance for traffic to or from any point served only by the UPSP and/or BNSF. We believe this process must be improved to enable much swifter resolution of such matters. This becomes even more imperative as we move toward a North American duopoly.

#### SHELL'S VIEWS

Shell has found that the theoretical reasons provided with each application for the consolidation of two or more railroads generally make good sense. Among these are the rationalization of duplicative rail properties so that more traffic is spread over less facilities cost, the creation of longer single-line hauls over shorter, more efficient routes, reducing interchange costs while increasing equipment utilization, and the elimination of redundant administrative functions and positions to reduce overhead costs. This makes

for a compelling case when topped off with a quantification of the total cost savings available to shippers as part of the public interest to be served.

Unfortunately, the promise of savings passed on to shippers is rarely fulfilled for several reasons. First, the total savings rarely materialize as unexpected expenses associated with the integration eat into the benefits. Second, the savings that do appear accrue more slowly than expected so that the immediate impact on the consolidated carrier's cost structure is much less dramatic than anticipated. Thirdly, the consolidated carrier discovers that its shippers actually have less access to rail to rail competition on one end of the haul or the other so the need to share merger savings is not quite so pressing. Lastly, and most importantly, as we have seen in the most recent consolidation, regardless of the best intention of the railroad towards the customer, the first obligation of the railroad is to its shareholders. Taken together, the above factors, absent competitive tension and effective processes to ensure rate reasonableness, enable the railroads to utilize differential pricing to recoup these costs at a disproportionate level from captive shippers.

Shell experience with regard to rail consolidation as it was handled during the 1990's is that the theories floated in the applications never make it into practice. On the contrary, there is generally a lessening of rail to rail competition, resulting in a greater concentration of railroad market power. Concentration of market power with the concomitant reduction of competition provides the ability for the involved carrier(s) to raise rates without fear of losing business.

In mergers where planning was inadequate, and/or the buyer had a poor understanding of what is being bought and/or the implementation was botched, the



resulting degradation of service was so severe and the consequences so far reaching that the projected shipper financial and operating benefits may be lost forever.

Shell continues to believe that increased competition, not increased regulation, is the answer to the problems which currently plague the railroad industry. By incorporating actions which increase competition into the merger approval process, many of the specific concerns set forth in the Advance Notice of Proposed Rulemaking would be effectively addressed in the marketplace. Following are the key actions which Shell believes the Board should utilize to promote increased competition as part of the merger review process.

A prerequisite of the approval of another large rail consolidation should be structural changes which reduce the concentration of market power and increase competition for all affected rail shippers. By requiring that conditions be met which will result in increased competition, the Board will reduce the need for future regulation. Among the key elements necessary are increased competition through an interswitching arrangement, open gateways to reduce bottleneck situations and effective processes to successfully challenge unreasonable rates. This approach is consistent with the Board's statutory mandate to ensure that merger approvals are consistent with the public interest.

The public interest, which is a composite of consumers plus the railroads, their customers and their employees, would certainly be served by increased competition in the railroad industry. Increased competition will not be a good thing for every railroad but will be great for the railroad industry. Just as some railroads adapted to and prospered in the new environment created by the Staggers Act, while some railroads disappeared, so too will there be individual winners and losers in a competitive environment. The

important point is that, as competition is injected in the place of the market concentration which now exists, we will see new, innovative services, better asset utilization, increased profits and a resulting increase in the investment capital flowing to the railroad industry.

There are serious questions in the railroad industry at the present time regarding capacity constraints. Infrastructure and capacity issues have been cited by the railroads as factors in recent service problems. This is another indicator of lack of competition and concentration of market power. In truly competitive markets, supply will be made available to meet increased demand, either by existing suppliers infusing new capital which flows to the demand or by new suppliers. Infrastructure problems about which railroads currently complain would be alleviated if barriers to entry in the railroad industry were lowered. Consolidation promises increased profits and therefore increased attraction of capital, but continuing to operate within the same paradigm guarantees stagnation, lower returns, less attraction for capital. Injection of competition into the telecommunications industry created opportunity which attracted capital resulting in an increase in capacity and infrastructure far beyond what could have been imagined when industry market power was concentrated.

With regard to the review of “downstream effects” and the anticipated strategic responses of other railroads to a particular proposed merger transaction, Shell believes that the railroads that are still experiencing service problems related to past consolidations should focus on addressing those problems. However, this does not preclude consideration of further consolidations, particularly when they involve carriers that do not have current significant service issues. The solution to current service difficulties will start with carriers developing a customer focus and taking care of the

business they have rather than continuing to look toward consolidation as a panacea for all railroad industry ills. Shell believes that enhancing competition in the industry will enable the marketplace to operate in a manner that rewards good business decisions and holds accountable those responsible for poorly executed transactions, through the gain or loss of traffic. Without such competition, the market cannot respond in the appropriate manner.

Shell is not prepared to render an opinion at this time on the application for merger to be filed by Canadian National and Burlington Northern Santa Fe. In contrast to the service disasters we encountered in the consolidations cited above, we experienced smooth transitions with the integrations of both the Burlington Northern – Santa Fe and Canadian National – Illinois Central mergers.

The current structure of the North American railroad industry is that of a three pronged duopoly with UP and BNSF in the western United States, CSX and NS in the eastern United States, CN and CP in Canada. The industry seems to be moving inevitably toward an end game in which only two railroads will remain.

If current trends continue we face the specter of a North American railroad duopoly with no effective regulatory oversight and without the prospect of economic constraints or service innovations engendered by unfettered competition. A duopoly which is economically deregulated while operating impenetrable franchises is naturally unresponsive to customers. Supply Chain efficiency requires that we find other ways to operate when one component of the supply chain is inefficient, non-responsive and makes untenable economic demands.

Under this scenario further railroad loss of transportation market share to other modes will occur, where possible, customer reinvestment decisions precluding rail involvement in the supply chain will be made, and those with no other option will create a backlash resulting in re-regulation of the railroads. Shell does not want to see this happen.

Shell does not propose re-regulation, but rather further deregulation that will allow competition. The United States railroad industry was only partially deregulated with the implementation of the Staggers Act. That legislation has been interpreted by regulators for twenty years in such a manner as to provide pricing freedom in combination with protection from rail to rail competition.

In the beginning, perhaps the railroads needed such protection. That day has passed. To continue to grow and strengthen, competition is needed in the industry. We do not propose that Open Access be declared tomorrow. This would not be healthy for railroads or shippers, nor would it be in the public interest. Rather we see the current proposed consolidation of the CN and BNSF as an opportune time to begin to reinvigorate the North American railroad industry by slowly introducing rail to rail competition.

This proposed merger provides the opportunity to apply the limited access rules under which the CN already operates in Canada to the environment in which it will operate in the United States. The adaptation and introduction of Canadian interswitching rules in the United States would be a small, not very painful, step toward rail to rail competition.

Interswitching refers to the movement of loaded and empty railcars to and from a shipper's facility to an interchange with a second railway within a specified distance and at a prescribed rate. It provides competitive access to another rail carrier for shippers captive to a single railway carrier, but within a prescribed distance of another rail carrier.

The rates are updated annually based on changes in the costs which underlie them. The interswitching fee is paid by the competing carrier to the delivering carrier. The delivering carrier providing an interswitch is required to provide the same level of service as if it had the long haul.

The Canadian interswitching rules have been beneficial to shippers by increasing competition without harming Canadian railroads. Although approximately seventy percent of shippers in Canada are captive to one carrier, only about five percent of traffic is interswitched because the carriers serving the shipper facilities have competed vigorously to retain the traffic. Since the inception of these new rules, there has been no adverse revenue impact on Canadian railroads.

While Canadian interswitching provides a greater degree of Competitive Access than we currently enjoy in the United States, it would not be difficult to implement operationally or administratively.

Another key element of increasing competition is to ensure that all viable gateways remain open, both operationally and economically. The effect of prior consolidations has been to create or lengthen bottlenecks and reduce or eliminate shipper routing options. This trend must be reversed.

Even with the above remedies, many captive shipper situations will continue to exist. It is therefore essential that effective mechanisms be available to shippers to challenge

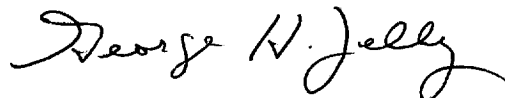
unreasonable rates. The current process is ineffective, burdensome and so costly as to be rendered impractical in most situations. A significant streamlining of the market dominance and rate reasonableness procedures is essential to ensure that all rail shippers can obtain reasonably priced service from rail carriers that are responsive to their needs.

The long run viability of the North American railroad industry would depend on a much more vigorous form of competition, which would result in a much more vigorous industry while at the same time enhancing the competitiveness of North American refineries, plants, manufacturing and production facilities. As industry success is achieved with limited competition the more successful purveyors of rail transportation would be drawn toward one of the models where infrastructure is separated from operations and yet additional competition is introduced through non-discriminatory access.

The introduction of such a paradigm to the North American railroad industry would result in an explosion of traffic growth, service innovation and profits which would impact the industrial sector of our economy in much the same way that telecommunications competition is now impacting our information sector.

Respectfully submitted,

SHELL CHEMICAL COMPANY  
For itself and as Agent for Shell Oil Company  
By its Senior Transportation Representative

A handwritten signature in cursive script, reading "George H. Jelly".

George H. Jelly  
One Shell Plaza  
Houston, Texas 77252

Dated: May 15, 2000

**CERTIFICATE OF SERVICE**

Pursuant to the Board's Order of April 28, 2000, a copy of the foregoing has been served by United States mail, postage pre-paid, to all parties of record this 15<sup>th</sup> day of May, 2000.

George H. Jelly  
Shell Chemical Company